Supreme Court, U.S.
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IN THE

Supreme Court of the United States

October Term, 1961

No. 805

NATHAN HAUSMAN, JOSEPH APPLEBAUM, THE APPLEBAUM FOUNDATION, INC., ALFRED N. BARNETT, JULIE A. BUCKLEY, as remaining trustee u/w of Daniel Buckley, deceased, PETER FUNDARO, HAROLD MALTZ, NORVIN H. RIESER, FRED WEIBERT and REGINA WEIBERT and L. H. LUCKETT, in their own behalf as stockholders of Pantepec Oil Company, C. A., and in behalf of all other such stockholders similarly situated,

Petitioners,

against

JOHN W. BUCKLEY, THE CATAWBA CORPORATION and PANTEPEC OIL COMPANY, C. A.,

Respondents.

BRIEF OF RESPONDENT PANTEPEC OIL COMPANY, C. A. IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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BRIEF OF RESPONDENT PANTEPEC OIL COMPANY, C. A. IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Question Presented

The sole question presented is whether the court below correctly held, in affirming a judgment dismissing a minority shareholders' action brought on behalf of a Venezuelan corporation, that New York conflict of laws principles required the application of domiciliary Venezuelan law to determine the right to maintain the action in a New York federal court.

The subsidiary "Questions Presented", as stated by petitioners, are argumentative in form and were necessarily disposed of by the decision below.

Statement of the Case

The original complaint[1] in this suit was filed in the United States District Court for the Southern District of New York on April 18, 1957. The third amended complaint (66a)[2], on the basis of which the determinations below were made, was served on May 15, 1959.

The petitioners are minority stockholders of respondent Pantepec Oil Company, C. A., a Venezuelan business corporation. In their third amended complaint on behalf of Pantepec, petitioners invoked federal jurisdiction on the ground of diversity of citizenship and charged, in three counts:

1. That a certain contract between Pantepec and defendant Phillips Petroleum Company constituted an unlawful sale under Venezuelan law of Pantepec's Venezuelan properties (66a); rescission and damages were demanded (81a);

2. That the individual defendants, officers and directors of Pantepec (only one of whom, director John W. Buckley, was before the court), were responsible to Pantepec in having caused Pantepec to enter into the Phillips contract (71a); damages for breach of a fiduciary duty to the corporation were demanded (81a);

3. That defendant Buckley and a company allegedly dominated by him, The Catawba Corporation, caused Pantepec to enter into an unlawful management services contract with Catawba (74a); cancellation of that agreement and damages for corporate waste were demanded (81a).

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[1] Appendix A to respondent's brief in the court below.

[2] Numbers followed by "a" refer to the Appendix to petitioners' brief as appellants in the court below.

Plaintiffs made no application to the stockholders for relief (70a), nor did they claim that a disinterested majority of stockholders does not exist.[3]

In their answers to the third amended complaint, all of the defendants set up affirmative defenses contesting the right of the plaintiffs to maintain the action under the law of Venezuela (94a, 123a, 4a). Under Rule 2 of the General Rules of the District Court for the Southern District of New York, the case was assigned for all purposes to Judge Lloyd F. MacMahon. Thereafter, upon motion of the defendants, Judge MacMahon decided on June 27, 1960 that Venezuelan law, applicable under controlling New York conflict of laws principles, would determine the right of the plaintiffs to enforce a corporate claim; and that the content of this foreign law raised a question of fact which should be resolved at a separate trial before further proceedings on the merits of the issues raised by the complaint (12a).

However, on April 17, 1961, the day set for the separate trial on the question of Venezuelan law, plaintiffs moved to strike the defenses of Buckley, Catawba and Phillips which contested their right to bring the action; and also moved to strike Pantepec's answer and the appearance entered on its behalf by its attorneys (130a). These motions were promptly denied at the preliminary trial held before Judge MacMahon, sitting without a jury (137a, 184a).

At the trial, plaintiffs conceded that under Venezuelan law stockholders have no right to enforce any claim in favor of their corporation against officers, directors or third parties (138a). Nevertheless, defendants presented proof establishing that the right to enforce a claim in favor of a Venezuelan corporation is vested exclusively in the stockholders' meeting, which may bring suit through the appointment of persons to represent it for that purpose (19a-20a).

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[3] Appendix A to Petitioners' brief, p. 40, ftn. 18.

On June 8, 1961 Judge MacMahon filed his findings of fact and conclusions of law (15a). Although finding that, under the Venezuelan law, there are various substantive rights accorded to a stockholder of a Venezuelan business corporation to take action with respect to wrongful conduct by its officers or directors or by a stockholders' meeting, he specifically found (23a):

> "30. No single stockholder or group of stockholders of a Venezuelan business corporation is granted any right under the Venezuelan Commercial Code or any other provision of Venezuelan law which entitles him or them to maintain an action either in behalf of himself or themselves, or in behalf of the corporation, for damages allegedly caused to the corporation by its directors, officers or third parties.
>
> "31. The foregoing findings reflect the policy of the Venezuelan law to the effect that neither an individual stockholder nor the court is best fitted to determine whether it is to the interest of a Venezuelan business corporation to enforce corporate claims even if those claims are founded on plainly unlawful conduct participated in by corporate officers and directors; that only the stockholders' meeting may decide not only if the claims have merit but also if the collective corporate welfare is best promoted by suing upon them.
>
> "32. Assuming the truth of the allegations of each of the counts of the complaint herein, except for allegations as to the content and effect of Venezuelan law, a minority shareholder, upon any theory under the law of Venezuela, may not maintain an action for any of the relief prayed for in the complaint."

Judgment for defendants was entered on June 29, 1961.

Thereafter, plaintiffs appealed from so much of the judgment as dismissed counts 2 and 3 of their complaint, preferring not to appeal from the dismissal of the first count which was directed only against Phillips (8a). In

effect, therefore, plaintiffs by this means discontinued their derivative action against Phillips.

The Court of Appeals, by unanimous decision, with a carefully reasoned opinion written by a member of that court who admittedly "has extensive training and experience in New York law",[4] considered the contentions which petitioners now raise in this Court, and rejected them. On the basis of conclusive New York and federal authorities, the court agreed with the trial judge that reference should be made to Venezuelan law, since petitioners' right to bring the action concerned the very nature and quality of their substantive rights, powers and privileges as stockholders of a Venezuelan corporation; that the courts of New York adhere to the "internal affairs" choice-of-law rule; that the New York "grouping of contacts" doctrine is not applicable to corporate stockholder litigation; and that New York courts would not refuse, for reasons of public policy, to apply Venezuelan law in this particular case.

Argument

Essentially, petitioners' request for certiorari is based upon the simple assertion that, since the Court of Appeals of New York has not passed upon the identical question presented herein, the federal court below in rejecting their arguments has refused to fulfill its "role as the counterpart of the state court of last resort."[5]

Even if this assertion were not completely refuted by the wealth of authorities cited in the opinion below, no valid reasons are stated in the petition which should incline this Court to grant certiorari.

All that is involved in this case is a question of state law on which petitioners have received the considered de-

[4] Petitioners' brief, p. 12, ftn. 7.

[5] Petitioners' brief, p. 12.

termination of two federal courts. This is not a case involving a conflict among circuits in the determination of a reviewable question, and no "important question of local law in any way probably in conflict with applicable local decisions" is involved. See *Ruhlin* v. *N. Y. Life Ins. Co.*, 304 U. S. 202, 206 (1938). There is no occasion for review. *Huddleston* v. *Dwyer*, 322 U. S. 232 (1944); *Bernhardt* v. *Polygraphic Co., of America*, 350 U. S. 198 (1955).

Petitioners' criticism of the reliance of the court below on *Newman* v. *Baldwin*, 13 Misc. 2d 897, 179 N. Y. S. 2d 19 (Sup. Ct. N. Y. Co. 1958), among numerous other decisions, is ill-founded. Although petitioners sought no reargument of the decision below, they now claim[6] that the court seems to have overlooked the decision of this Court in *King* v. *Order of United Commercial Travelers of America*, 333 U. S. 153, 161 (1948). But *King* held merely that a federal court of appeals is not required to follow an unreported decision by a South Carolina county court of common pleas where there was nothing in the decisions of the South Carolina Supreme Court inconsistent with a contrary view based upon " 'reason and the very considerable authority' from other jurisdictions." *Ibid*, p. 156. *King* is entirely consistent with *West* v. *American Telephone & Telegraph Co.*, 311 U. S. 223, 236 (1940) in which this Court remarked:

> "A state is not without law save as its highest court has declared it. There are many rules of decision commonly accepted and acted upon by the bar and inferior courts which are nevertheless laws of the state although the highest court of the state has never passed upon them. In those circumstances a federal court is not free to reject the state rule merely because it has not received the sanction of the highest state court, even though it thinks the rule is unsound in principle or that another is preferable."

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[6] Petitioners' brief, p. 11.

Indeed, the court below clearly recognized its duty in stating that "a federal court must 'give respectful heed to the pronouncements even of inferior state tribunals of record,' *Mayer* v. *Chase National Bank*, 233 F. 2d 468, 470 (2d Cir.), cert. denied 352 U. S. 841 (1956) * * *."[7]

Petitioners' contention that the court should have searched for a "developing line of authority" in New York overlooks the primary duty of a federal court "to ascertain from all the available data what the state law is and apply it rather than to prescribe a different rule, however superior it may appear from the viewpoint of 'general law' * * *." *West, supra*, p. 237. In this respect, the court below performed its duty precisely:

> "Even if we were to assume, as appellants suggest, that these cases do not conclusively demonstrate that New York courts would apply the 'internal affairs' rule in the present case, it would still be necessary for this Court, absent state authority directly in point, to forecast what rule they would follow in this instance. *Hahlas* v. *Armour & Co.*, 270 F. 2d 71, 75-76 (8th Cir. 1959); *Yost* v. *Morrow*, 262 F. 2d 826, 828 (9th Cir. 1959); *Steinberg* v. *Hardy*, 90 F. Supp. 167, 169 (D. Conn. 1950). In view of the well established law illustrated by the cited cases and the widespread use of the 'internal affairs' rule elsewhere, we believe the New York courts would adopt that rule, if they have not already done so."[8]

In the first instance, the court below held that, under New York law, the issue as to the right of a stockholder of a foreign corporation to sue on the corporation's behalf was a matter of substantive rather than procedural law. The decisions relied upon fully support this decision. *Coster* v. *Coster*, 289 N. Y. 438, 46 N. E. 2d 509 (1943). See *Cohen* v. *Beneficial Industrial Loan Corp.*, 337 U. S. 541, 556 (1949); *Wood & Selick, Inc.* v. *Compagnie Generale*.

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[7] Appendix A to Petitioners' brief, p. 33, ftn. 10.

[8] Appendix A to Petitioners' brief, pp. 34-5.

Transatlantique, 43 F. 2d 941, 942-3 (C. C. A. 2, 1930). Cf. *Newman* v. *Baldwin*, 13 Misc. 2d 897, 179 N. Y. S. 2d 19 (Sup. Ct. N. Y. Co. 1958); *Milty* v. *Adams*, 16 F. R. D. 105 (S. D. N. Y.), *remanded*, 217 F. 2d 647 (2d Cir. 1954); *Bankers Nat. Corp.* v. *Barr*, 7 F. R. D. 305 (S. D. N. Y. 1945).

Petitioners' main disagreement with the reasoning of the court below is concerned with the application of the "internal affairs" rule, instead of the "contacts" theory of *Auten* v. *Auten*, 308 N. Y. 155, 124 N. E. 2d 99 (1954), to the issue of their right to maintain a stockholders' derivative action. The careful research indicated in the opinion below, however, confirms the propriety of rejection of the *Auten* theory in favor of the clearly enunciated "internal affairs" rule under New York law. *Newman* v. *Baldwin*, *supra*, merely reflects the firmly established principle that the right of a stockholder to object to corporate conduct is determined by the law under which the corporation was created. *Russian Reinsurance Co.* v. *Stoddard*, 240 N. Y. 149, 147 N. E. 703 (1925). Cf. *Long Park, Inc.* v. *Trenton-New Brunswick Theatres Co.*, 297 N. Y. 174, 182, 77 N. E. 2d 633, 636 (1948); *German-American Coffee Co.* v. *Diehl (No. 1)*, 216 N. Y. 57, 109 N. E. 875 (1915); *Vanderpool* v. *Gorman*, 140 N. Y. 563, 35 N. E. 932 (1894); see also *Matter of American Fibre Chair Seat Corp.*, 265 N. Y. 416, 420, 193 N. E. 253, 255 (1934).

Moreover, the "internal affairs" rule has been consistently applied by New York federal courts as requiring reference to the law of the place of incorporation. See *Upson* v. *Otis*, 155 F. 2d 606 (2d Cir. 1946); *Koster* v. *(American) Lumbermens Mut. Casualty Co.*, 153 F. 2d 888 (2d Cir. 1946), *aff'd*, 330 U. S. 518 (1947); *Bankers Nat. Corp.* v. *Barr*, 7 F. R. D. 305 (S. D. N. Y. 1945); *Milty* v. *Adams*, 16 F. R. D. 105 (S. D. N. Y. 1954), *remanded*, 217 F. 2d 647 (2d Cir. 1954); *Harr* v. *Pioneer Mechanical Corp.*, 2 F. Supp. 517 (S. D. N. Y. 1932), *modified*, 65 F. 2d 332 (2d Cir. 1933), *cert. denied*, 290 U. S. 673 (1933).

Indeed, the foregoing principles and their consistent application by New York federal courts are based upon the simple proposition that a shareholder derives his status from the law of the place of incorporation and his rights vis-a-vis his corporation must therefore be determined by such law. *Rogers* v. *Guaranty Trust Co.*, 288 U. S. 123 (1933); *Canada Southern Ry.* v. *Gebhard*, 109 U. S. 527 (1883). And when the law of the place of incorporation, which created the status of the stockholder, conditions his right to sue on its behalf, such condition "will be observed elsewhere". See *Wood & Selick, Inc.* v. *Compagnie Generale Transatlantique*, 43 F. 2d 941, 942-43 (C. C. A. 2, 1930).

The "contacts" rule of *Auten* has never been applied by the New York courts to stockholder litigation and petitioners have shown no "developing line of authority" to that extent. Certainly, the *Auten* rule has not displaced in New York the "internal affairs" rule. Even petitioners concede that the *Auten* rule has been applied so far only in contract and tort litigation.[9]

Nor is the New York Business Corporation Law, §§ 1317-20, effective April 1, 1963, indicative of a trend in legislative, much less judicial, thinking with which the court below should have concerned itself. There is nothing in the record in this case to indicate that Pantepec is authorized to conduct or actually conducting business in New York with at least two-thirds of its outstanding stock or two-thirds of its voting stock owned by residents of the state, or with two-thirds of its business or investment income allocable to the state for franchise tax purposes.

Finally, New York public policy, as expressed in its decisions, is entirely consistent with the result below. Venezuelan law, although different from New York law, is neither fundamentally unfair nor unjust. Venezuelan law on the subject of shareholders' suits is substantially similar

[9] Petitioners' brief, p. 15.

to the law of Massachusetts. This similarity, whereby corporations are considered best suited to govern their own affairs, is illustrated by the opinion in *Pomerantz* v. *Clark*, 101 F. Supp. 341 (D. Mass. 1951) which, effectively, is summarized in the following finding of the trial court (23a).

> "31. The foregoing findings reflect the policy of the Venezuelan law to the effect that neither an individual stockholder nor the court is best fitted to determine whether it is to the interest of a Venezuelan business corporation to enforce corporate claims even if those claims are founded on plainly unlawful conduct participated in by corporate officers and directors; that only the stockholders' meeting may decide not only if the claims have merit but also if the collective corporate welfare is best promoted by suing upon them."

American investors in Pantepec are not deprived by the decision below of the substantial rights and remedies accorded to them as stockholders under Venezuelan law (21a-23a). These petitioners have chosen to ignore the law of their corporate domicile. Instead, they have sought to assert rights in this jurisdiction which the chartering country does not give them. They have had adequate opportunity to voice their contentions in the courts below and do not require another federal forum.

Conclusion

The petition for certiorari should be denied.

Respectfully submitted,

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Attorneys for Respondent,
Pantepec Oil Company, C. A.

Dated: May 4, 1962.